

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

DATE: [REDACTED]
SURNAME: [REDACTED]

Date:

APR 25 2001

Contact Person: [REDACTED]
ID Number: [REDACTED]
Telephone Number: [REDACTED]

[REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3) of the Code. Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

The [REDACTED] ([REDACTED]) Articles of Incorporation state, in part, that it is "organized for charitable purposes, including acting as a vehicle to assist entities whose objective is to create economic development in areas which are under served by traditional capital markets." The [REDACTED] also states in its application that it will identify the specific nature of local capital gaps and work with the private sector financial community to create a series of developmental venture capital equity investment funds in each of the targeted regions. The [REDACTED] is encouraging the formation of a unique type of venture capital fund that is customized to serve under-resourced regions and communities. The [REDACTED] mission is to prepare an area so that private equity investors will come into that area, and invest "risk capital" in the region's businesses, thereby enabling those local businesses to grow and employ local residents.

The [REDACTED] has a current relationship with [REDACTED] ([REDACTED]), a public affairs consulting firm located in [REDACTED]. [REDACTED] offers consulting services in the following areas: financing advisory services, fundraising and capitalization strategies, fund management capabilities, business strategies for new companies, public relations and communications and specialized recruitment services.

The [REDACTED] currently occupies offices in the [REDACTED] suite, but is developing a formal agreement through an administrative contract for use of office resources and occupancy. [REDACTED] the Executive Director of the [REDACTED] has been an employee of [REDACTED] but will discontinue in this capacity and will fully transition to the [REDACTED] when funding permits. The [REDACTED] expects to use the services of [REDACTED] initially, though there will be no expectation of exclusivity with this relationship. The [REDACTED] entered into an agreement with [REDACTED] which provides that the [REDACTED] agrees to pay [REDACTED] \$ [REDACTED] per month for administrative support (which includes office space, telephone and internet lines, use of office supplies and office equipment) and staff support (which includes assistance with receptionist and bookkeeping responsibilities, and general administrative duties). Additionally, the [REDACTED] has indicated that it contemplates entering into contractual relationships with entities such as [REDACTED] for specific services related to the development of new equity investment vehicles. Specifically, [REDACTED] will retain entities such as [REDACTED] to provide two specific functions: to help recruit experienced fund managers, and to identify and deal with potential investors for certain regional funds that [REDACTED] helps to spin-off.

Section 501(c)(3) of the Internal Revenue Code provides for the exemption of organizations that are organized and operated exclusively for religious, charitable, or educational purposes, no part of the net earnings of which inures to the benefit of any shareholder or individuals.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations ("regulations") states that in order for an organization to be exempt as an organization described in section 501(c)(3), it must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that, in general, an organization is organized exclusively for one or more exempt purposes only if its articles of organization limit the purposes of such organization to one or more exempt purposes, and do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(c) of the regulations defines "private shareholder or individual" as persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization will not be considered as operating exclusively for charitable purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of section 1.501(c)(3)-1(d)(1) unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interest.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" as used in section 501(c)(3) of the Code includes relief of the poor and distressed or of the underprivileged.

Section 1.501(c)(3)-1(e) of the regulations provides that an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

Rev. Rul. 67-5, 1967-1 C.B. 123, concerned a foundation controlled by its creator's family and operated to enable the creator and his family to engage in financial activities which were beneficial to them, but detrimental to the foundation. The Service concluded that the foundation was operated for a

substantial non-exempt purpose and served the private interests of the creator and his family. The ruling reasoned as follows:

The use of the foundation as a vehicle for activities advantageous to its creator and his family and as a source of funds to finance such activities, the resulting investments by the foundation in assets that fail to produce income for a charitable program commensurate in scope with its financial resources, the continued failure of its trustees to protect the value of these investments, and their failure to make them income-producing, all establish that the foundation is operated for a non-exempt purpose, substantial in nature. That purpose is to serve the private financial interests of its creator and his family. . . Furthermore, the foundation fails to serve a public, rather than a private, interest and therefore is not operated exclusively for charitable purposes.

Thus, the foundation was not entitled to exemption under section 501(c)(3) of the Code.

Rev. Rul. 72-369, 1972-2 C.B. 245, provided that an organization formed to provide management and consulting services to unrelated exempt organizations does not qualify for exemption under section 501(c)(3). This Rev. Rul. also states that providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit.

In At Cost Services, Inc. v. Commissioner, T.C. Memo. 2000-329, the court held that petitioner did not qualify as a section 501(c)(3) exempt organization because it benefits the private interest of its founder, Fondel, and of the limited liability company more than incidentally. The organization's sole founder, director, and officer is Matthew Fondel. The organization counsels and trains unemployed or underemployed individuals to become temporary service workers and works in conjunction with a limited liability company whose members include Fondel and the organization. The court found that the activities of the organization constitute the conduct of a temporary service agency, which is essentially a commercial venture and the organizations' own services or the services of its clients are in direct competition with for-profit businesses in the temporary service field. Additionally, the court noted that the organization benefits the private interest of its founder.

In International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36, the court held that the Service had properly revoked the section 501(c)(3) status of an organization that did not operate exclusively for exempt purposes. The court based its conclusion, in part, on the fact that a related for-profit corporation had benefited substantially from the manner in which the activities of the exempt organization were conducted. In these circumstances, the court said, an organization is not operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code, even though it furthers other exempt purposes. In this case, the organization had the substantial non-exempt purpose of benefiting a for-profit travel agency controlled by parties related to the organization. The organization had been formed and was controlled by an individual who had previously operated all tour operations through a for-profit entity. The travel agency received substantial fees from customers attending tours promoted by the organization, under a non-competitive arrangement.

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), the court upheld denial of 501(c)(3) status to an organization because it was operated for the non-exempt purpose of providing a market for the services of a for-profit fund-raising firm owned by parties related to the organization. Key facts considered by the court included that employees of the for-profit firm devoted two-thirds of their time to the organization's business; that the majority of the organization's income went to payments to the for-profit firm; and that the controlling parties profited from the relationship.

[REDACTED]

Est. of Hawaii v. Commissioner, 71 T.C. 1067 (1979), held that an organization that was essentially controlled by a separate for-profit commercial entity was operated for a substantial non-exempt purpose where it promoted a certain body of knowledge, which was owned by that commercial entity. Whether the agreements between the parties reflected arm's length negotiation was irrelevant to the analysis. The court noted that the commercial entity was trading on the organization's tax-exempt status.

In Senior Citizens of Missouri, Inc. v. Commissioner, T.C. Memo 1988-493, the court denied section 501(c)(3) of the Code status to an organization because it paid unexplained advances to its solicitors representing 33.2% of its gross revenues. The court found this to be clearly substantial. Thus, it failed the operational test of section 501(c)(3).

In Better Business Bureau v. United States, 326 U.S. 279, 283 (1945), the U.S. Supreme Court noted that the presence of a single substantial nonexempt purpose precludes exempt status for the organization, regardless of the number or importance of exempt purposes.

In People of God Community v. Commissioner, 75 T.C. 127 (1980), the organization paid its minister, also a director who controls the organization, compensation based on a percentage of the organization's gross receipts. The Court found that with such compensation arrangement, a portion of the organization's earnings is being passed to the minister, and paying over a portion of gross earnings to those vested with control of an organization constitutes private inurement. Accordingly, the Court held that the organization is not exempt under section 501(c)(3) of the Code.

In B.S.W. Group, Inc. v Commissioner, 70 TC 352 (1978), the Tax Court held that an organization offering consulting and research services for a fee to various nonprofit organizations did not qualify for exemption under section 501(c)(3) of the Code. The fees charged were set at or close to cost, but in no event would they be less than the amount needed to cover the cost of providing services. Several factors were listed by the court as militating against exemption. The organization's financing did not resemble that of the typical 501(c)(3) organization in that it did not solicit or receive voluntary contributions from the public. Its only source of income was fees for services. Other negative factors were the manner in which the organization's activities were conducted, the commercial hue of those activities, competition with commercial firms providing similar services, and the existence and amount of annual or accumulated profits.

Here, the [REDACTED] is not organized and operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code. The [REDACTED] primary purpose and activity is creating equity investment vehicles, or developmental venture capital funds, and to subcontract with consultants who assist with regional research, recruitment of fund managers and investor relations. The creation of new developmental venture capital funds constitutes a substantial nonexempt purpose and activity within the meaning of section 1.501(c)(3)-1(c)(1) of the regulations. See also Rev. Rul. 72-369 and B.S.W. Group, Inc., *supra*. The creation of equity investment vehicles serves the private business interests of WC, the portfolio companies, and the investors, rather than public interests pursuant to section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

The [REDACTED] programs and activities are indistinguishable from those conducted by for profit enterprises. The [REDACTED] organizes resources such as technical assistance providers and business development consultants for entrepreneurs, and builds coalitions among the community, businesses, educational organizations, and government agencies. The [REDACTED] also conducts feasibility studies and market research, working with the community, investors, and legal and accounting professionals to design an appropriate structure for the fund. The [REDACTED] recruits fund managers, assembles materials, and

seeks investors for the new funds. All of these activities would be undertaken by a for-profit enterprise before it invests capital into an area. The [REDACTED] sole charitable purpose is that it will conduct such activities in "distressed" areas. However, [REDACTED] has indicated that project areas are carefully selected according to criteria balancing need with the probability of success, given the scope of an area. The regions selected by the [REDACTED] are fairly large in order to ensure that enough business activity will take place to create the conditions where an equity investment fund can flourish and add dynamism to the regional economy. Specifically, the regions were chosen based upon the number of small businesses that fit a typical profit of a small-scale equity investment fund portfolio company. One of the reasons then that the [REDACTED] considers for one of its target areas is "whether an equity investment fund can flourish." This substantiates that the [REDACTED] operates more as a for-profit business than a charitable entity. Given that the [REDACTED] may arguably benefit certain limited "distressed" areas, the charitable activity, versus a for-profit activity, is clearly incidental. See International Postgraduate Medical Foundation v. Commissioner, T.C. Memo 1989-36 (the organization had the substantial non-exempt purpose of benefiting a for-profit travel agency controlled by parties related to the organization); Church by Mail, Inc. v. Commissioner, 765 F.2d 1387 (9th Cir. 1985) (denial of 501(c)(3) status to an organization because it was operated for the non-exempt purpose of providing a market for the services of a for-profit fund-raising firm owned by parties related to the organization); and Est. of Hawaii v. Commissioner, 71 T.C. 1067 (1979) (organization that was essentially controlled by a separate for-profit commercial entity was operated for a substantial non-exempt purpose where it promoted a certain body of knowledge, which was owned by that commercial entity).

Furthermore, the [REDACTED] does not qualify as a section 501(c)(3) of the Code organization because it benefits the private interests of [REDACTED] more than incidentally. The [REDACTED] has submitted documents indicating that it will pay [REDACTED] \$[REDACTED] per month for administrative support as well as contracting with [REDACTED] for investment assistance. These nonexempt activities prevent the Council from meeting the requirements for a section 501(c)(3) organization. See Better Business Bureau v. U.S., 326 U.S. 279 (1945); and At Cost Services, Inc. v. Commissioner, T.C. Memo. 2000-329.

Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

[REDACTED]

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax-Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the address listed below. However, if you are sending your correspondence via hand delivery please call this office.

Internal Revenue Service
[REDACTED] T:E0:RA:T:3
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,
(signed) Robert C. Harper, Jr.

Robert C. Harper, Jr.
Manager, Exempt Organizations
Technical Group 3

	Initiator	Reviewer	Reviewer	Reviewer
Code	[REDACTED]	[REDACTED]		
Surname	[REDACTED]	[REDACTED]		
Date	[REDACTED]	[REDACTED]		